Statutes—Continued

	Page
Sec. 708(a)	12
Sec. 708(b)	12
Sec. 7701	12
Sec. 7701(a)	2, 11, 12, 15

Miscellaneous:

Cohen, Gelberg, Surrey, Tarleau, and Warren, *Corporate Liquidations under the Internal Revenue Code of 1954*, 55 Colum. L. Rev. 37 (1955)	10
H. Conf. Rep. No. 2543, 83d Cong., 2d Sess.	10
House Hearings before the Committee on Ways and Means on General Revenue Revision, 83d Cong., 1st Sess.	10
H. Rep. No. 1337, 83d Cong., 2d Sess.	10
S. Rep. No. 1622, 83d Cong., 2d Sess.	10

In the Supreme Court of the United States

OCTOBER TERM, 1969

No. 1036

BAKER COMMODITIES, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1–16) is reported at 415 F. 2d 519. The opinion of the Tax Court (Pet. App. 17–81) is reported at 48 T.C. 374.

JURISDICTION

The judgment of the court of appeals was entered on August 8, 1969 (Pet. App. 1). Petitioner's petition for rehearing was denied on October 7, 1969 (415 F. 2d 519). The petition for a writ of certiorari was filed on January 5, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

The ultimate issue here presented is whether the court of appeals erred in holding that petitioner's bases in assets acquired on liquidation of wholly-owned subsidiary corporations, effected immediately after acquisition of each subsidiary's stock, were the same as the bases which those assets had in the hands of the liquidated corporations, rather than petitioner's higher cost of its stock in the liquidated corporations. Resolution of that issue presents the following questions:

1. Whether the judicially promulgated *Kimbell-Diamond* doctrine [1] survived the enactment of Section 334(b)(2) of the Internal Revenue Code of 1954.

2. Whether, in the circumstances of this case, the courts below properly applied the statutory rules of stock attribution prescribed in Section 318 of the Code prior to its amendment in 1964.

3. Whether the courts below correctly determined that the Manchester Medical Hospital partnership continued to exist after the sale of its operating assets, because the partnership had not been dissolved or terminated and was still collecting and distributing the proceeds of the installment note it received in the sale.

STATUTES INVOLVED

The pertinent provisions of Sections 318, 334 and 708 of the Internal Revenue Code of 1954 are set forth in the Appendix to the petition (pp. 82–87). Section 7701(a)(2) of the Code is set forth in the Appendix, *infra*, p. 15.

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[1] *Kimbell-Diamond Milling Co.* v. *Commissioner*, 14 T.C. 74, affirmed *per curiam*, 187 F. 2d 719 (C.A. 5), certiorari denied, 342 U.S. 827.

STATEMENT

The present controversy concerns the proper bases to be assigned to assets acquired by petitioner, a California corporation, on liquidation of three wholly-owned subsidiary corporations. The stock of two of the subsidiaries, Baker Commodities, Inc. (herein called "Old Baker" to distinguish it from petitioner which bears the same name) and Kerman Tallow Works ("Kerman"), was acquired by petitioner on June 26, 1961, and these subsidiaries were liquidated on June 30, 1961. The stock of the third subsidiary, Veronica Compania Naviera, S.A. ("Veronica") was acquired on December 20, 1962, and that subsidiary was liquidated not later than December 31, 1962. (Pet. App. 5–6, 29, 37–38, 49–51.)

The following facts are relevant to the application of the "attribution" rules of Section 318 of the Internal Revenue Code:

1. Petitioner acquired all of Old Baker's stock and 50 percent of Kerman's stock from the Jerome Brothers partnership (the "Partnership"), whose partners were Frank, Varney and Paul Jerome (the "Jeromes"), and the balance of Kerman's stock from the R. S. Wilson Company, which was owned by Robert S. Wilson. It acquired all of Veronica's stock from the Jeromes. As of June 26, 1961, and at all relevant times thereafter, the Jeromes, six key employees of the Partnership and Jack Keith each owned 10 percent of petitioner's outstanding stock. (Pet. App. 3–6, 21–23, 28–29, 49–50.)

Apart from the Partnership, the Jeromes were members of a general partnership called Keith Engi-

neering Company ("Keith"). Jack Keith was a 50 percent partner, and the other 50 percent was equally divided among the Jeromes. The Jeromes also were general partners in a limited partnership, Manchester Medical Hospital ("Manchester"), in which each owned a one-ninth interest. Five of the six key employees of the Partnership who were stockholders of petitioner also were limited partners in Manchester. (Pet. App. 6–7, 23–24, 43–45.)

2. Manchester was organized on or about January 1, 1958, for the purpose of constructing, owning and operating a convalescent hospital. A convalescent hospital was in fact built and operated by Manchester; however, it ran into severe financial difficulties and was shut down in July, 1960. On March 1, 1961, the partnership sold all of its assets to Southwest Community Hospital Association, a nonprofit corporation, which was unrelated to any of Manchester's partners or to any of the parties or entities involved in this case. Southwest gave a promissory note for the purchase price which was secured by a chattel mortgage and deed of trust on the hospital property. Information returns were filed by Manchester for its fiscal years 1961 and 1962. The 1961 return reported the sale of assets; the 1962 return, for the fiscal year ended August 31, 1962, reported collections on the installment sale of $36,623.97. No other receipts or income was reported on the 1962 return; however, the note from Southwest was shown as an asset with an amount due of $12,500. No proof of any final liquidation and distribution of the assets of this partnership was offered at trial. (Pet. App. 6–7, 43–45.)

3. Following the liquidations of Old Baker, Kerman and Veronica, petitioner apportioned the cost of the stock of each corporation to the assets distributed by that corporation in liquidation (Pet. App. 5–6). On audit of petitioner's income tax returns for the fiscal years ended June 30, 1962 and June 30, 1963, the Commissioner disallowed the new bases for the assets, which petitioner had taken in reliance on Section 334(b)(2) of the Internal Revenue Code. He determined that those assets had the same bases in petitioner's hands—which bases were lower than the cost of the stock—that they had had in the hands of the liquidated corporations. The Commissioner's determination was predicated on the ground that petitioner did not acquire the stock in the liquidated corporations by "purchase" as required by Section 334(b)(2) and defined in Section 334(b)(3), because (a) its shares in Old Baker and Kerman were acquired in exchanges to which Section 351 applied and (b) it acquired the stock of all three corporations from a person or persons—the Partnership or the Jeromes—whose ownership of the stock was attributable to petitioner under the rules of constructive stock ownership prescribed in Section 318(a). The Tax Court sustained the Commissioner's determination on both grounds (Pet. App. 64–75, 77–81). The court of appeals did not pass on the Section 351 issue. It affirmed on the second ground, holding that there was no "purchase" because, immediately prior to each acquisition, petitioner was deemed to own, by reason of the statutory rules of stock attribution, the stock it thereafter acquired (Pet. App. 8–16).

The court reached this conclusion by the following process (Pet. App. 9–10):

First, 30 percent of petitioner's stock was attributed to the Partnership, since each of the Jeromes owned 10 percent of petitioner's stock, and stock actually owned by a partner is deemed to be owned by the partnership. Section 318(a)(2)(A).

Second, an additional five percent of petitioner's stock was attributed to the Partnership through Keith. Jack Keith owned 10 percent of petitioner's stock and also owned a 50 percent interest in Keith, the other 50 percent being owned by the Jeromes. Since stock owned by a partner is deemed to be owned by the partnership, Jack Keith's 10 percent interest in petitioner is deemed to be owned by Keith. Half of that 10 percent interest is in turn attributable to the Jeromes because stock constructively owned by a partnership is deemed to be owned proportionately by its partners. Finally, the stock so attributable to the Jeromes is re-attributable to the Partnership. Sections 318(a)(2)(A) and 318(a)(4).

Third, an additional 16⅔ percent of petitioner's stock was attributed to the Partnership through Manchester. Five of Manchester's limited partners owned a total of 50 percent of petitioner's stock, and the Jeromes had a total ⅓ interest in Manchester. Therefore, under the same rules as were applicable to Keith, the Jeromes were deemed to own ⅓ of Manchester's 50 percent interest in petitioner, which was ultimately attributed to the Partnership. Sections 318(a)(2)(A) and 318(a)(4).

Fourth, because the Partnership was deemed to own a total of more than 50 percent of petitioner's stock (51⅔ percent), petitioner was deemed to own the stock acquired by it from the Partnership and did not, therefore, acquire that stock by "purchase." Sections 318(a)(2)(C)(ii) and 334(b)(3)(C).

Finally, the court rejected (Pet. App. 11–16) petitioner's claim that there should be no attribution of petitioner's stock through Manchester because Manchester had ceased to exist prior to the time of the liquidations in 1961 and 1962. It held that although Manchester sold its operating assets in March, 1961, the partnership was not terminated at the time of the liquidations, since it retained assets and had not itself been dissolved or liquidated by the end of 1962.

ARGUMENT

The decision below, affirming that of the Tax Court, is correct. There is no conflict or any other ground for further review by this Court.

1. Petitioner relies most heavily (Pet. 11) on the argument that the court of appeals erred in failing to invoke the *Kimbell-Diamond* doctrine[2] and that its decision conflicts in principle with the rationale followed by the Court of Claims in *American Potash & Chemical Corp.* v. *United States*, 399 F. 2d 194, on rehearing, 402 F. 2d 1000.

The *Kimbell-Diamond* doctrine, which was developed judicially under the 1939 Code, permitted a tax-

[2] *Kimbell-Diamond Milling Co.* v. *Commissioner*, 14 T.C. 74, affirmed *per curiam*, 187 F. 2d 718 (C.A. 5), certiorari denied, 342 U.S. 827.

payer that purchased the stock of a corporation for the sole purpose of liquidating it and acquiring the liquidated corporation's assets, to use, as the basis for the assets, the taxpayer's cost of the stock rather than the basis of the assets in the hands of the liquidated corporation. In enacting the 1954 Code, Congress incorporated the *Kimbell-Diamond* doctrine in Section 334(b)(2), which, on certain express conditions, provides an exception to the general rule of Section 334(b)(1), that property received by a corporation on liquidation of a subsidiary retains, in the hands of the transferee, the same basis that it had in the hands of the liquidated corporation. In *American Potash, supra,* the Court of Claims held that failure to comply with one of the conditions prescribed in Section 334(b)(2)—in that case the requirement of Section 334(b)(2)(B) that the stock of the subsidiary be acquired within a 12-month period—does not preclude a corporate taxpayer from acquiring a stepped up basis on liquidation of a subsidiary, if the taxpayer meets the requirements of the *Kimbell-Diamond* doctrine.

We submit that there is no conflict with *American Potash.* Petitioner did not argue in the Tax Court that this case was to be decided under the *Kimbell-Diamond* doctrine rather than by reference to Section 334(b)(2). Petitioner raised this issue for the first time in its petition for rehearing in the court of appeals (Pet. App. 90–93), which was denied without comment. Since the court of appeals usually does not consider new theories on petition for rehearing

(*Stephens* v. *Arrow Lumber Co.*, 354 F. 2d 732, 734 (C.A. 9); *Mitchell* v. *Greenough*, 100 F. 2d 1006 (C.A. 9)), there is no basis for the assumption that it gave any consideration to the merits of the argument based on the *Kimbell-Diamond* rationale. In these circumstances, and in the absence of any expression of views by the court of appeals regarding *Kimbell-Diamond*, it cannot be said that a conflict of any kind exists between the decision below and *American Potash*, or that the matter is in a proper posture for review by this Court.[3]

The petition does not suggest any reason why it would have been improper for the court of appeals to decline to consider, as untimely made, the argument that *Kimbell-Diamond* applies in this case. Refusal to consider that newly advanced argument on rehearing was particularly appropriate here, since a holding that the *Kimbell-Diamond* doctrine is still viable would not finally dispose of the case. A new trial would be necessary because the Tax Court, under the issues framed by petitioner, had no occasion to, and did not, make any findings of fact regarding petitioner's intent in acquiring the liquidated corporations.

Moreover, it is clear that the *Kimbell-Diamond* doctrine was supplanted by Section 334(b)(2) in cases involving acquisitions of stock by corporate taxpayers. Application of that doctrine created confusion because

[3] As petitioner acknowledges (Pet. 14), *American Potash* was remanded for a determination as to whether *Kimbell-Diamond* was applicable in the circumstances of that case. There is thus no final 1954 Code decision permitting a corporate taxpayer like petitioner to step up its basis in the assets of a liquidated subsidiary where it has failed to comply with the conditions prescribed in Section 334(b)(2).

it required factual findings as to subjective intent. This led to uncertainty in an area where certainty is essential. House Hearings before the Committee on Ways and Means on General Revenue Revision, 83d Cong., 1st Sess., pp. 1319, 1329–1330; Cohen, Gelberg, Surrey, Tarleau and Warren, *Corporate Liquidations under the Internal Revenue Code of 1954*, 55 Colum. L. Rev. 37, 40–43 (1955). Section 334(b)(2), with its objective criteria, was designed to provide the required certainty. H. Rep. No. 1337, 83d Cong., 2d Sess., pp. 38, A100, A109–A110; S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 48, 254, 257; H. Conf. Rep. No. 2543, 83d Cong., 2d Sess., p. 36. To hold that *Kimbell-Diamond* applies in the circumstances of this case thus would frustrate the principal purpose of Section 334(b)(2) and do violence to the manifest intent of the Congress which enacted that provision. See. S. Rep. No. 1622, *supra*, p. 257.

2. Petitioner concedes (Pet. 26, n. 14) that this is a case of first impression involving "multiple attribution" under Section 318. Petitioner also concedes (Pet. 26) that the result reached below "is no longer possible * * * because of the 1964 amendment to § 318."[4] This, without more, we submit, is a sufficient basis for this Court to deny further review of the Section 318 issue. But apart from the fact that the decision below is unique, there can be no doubt that both courts below correctly held that Section 318

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[4] Section 318(a)(5)(C), added by the Act of August 31, 1964, P.L. 88–554, 78 Stat. 761, Sec. 4, provides that stock is not to be attributed from partner to partnership and then to other partners. Had that provision been applicable here, the Partnership would not have been deemed to own any of the stock attributed to it through Keith and Manchester.

(prior to its amendment in 1964) required multiple reattribution of the stock of Old Baker, Kerman and Veronica. The pertinent statutory language is unequivocal, as petitioner acknowledged in the Tax Court (Pet. App. 80, n. 30), and petitioner cites no authority for its assertion (Pet. 24) that Congress did not mean precisely what it said.[5]

3. Similarly without merit is petitioner's contention that the courts below erred in holding that Manchester was a viable partnership for purposes of attribution under Section 318. The fact is that even at the time of the Veronica liquidation in December 1962, Manchester was in existence—none of its partners had withdrawn, its affairs had not yet been wound up and it had not been dissolved under applicable California law (Pet. App. 6–7, 11–16, 43–45). Manchester was, therefore, a partnership at all critical times within the meaning of Section 7701(a)(2), which defines a partnership to include "a syndicate, group, pool, joint venture, or any other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on."

Petitioner's argument that Manchester's existence or non-existence should be determined by reference

[5] Petitioner professes bafflement (Pet. 25) regarding the reattribution of the Veronica stock, since it acquired that stock from the Jeromes, while the stock of Old Baker and Kerman was acquired from the Partnership. It is sufficient to note that throughout these proceedings the Jeromes and the Partnership have been treated interchangeably (Pet. App. 5–6, 9–10, 77–81), and that at no time—even on rehearing—did petitioner question this treatment.

to Section 708(b), which relates to a termination of a partnership, rather than under Section 7701, is incorrect. Section 7701(a) provides that the definitions therein contained are to be applied "where not otherwise distinctly expressed or manifestly incompatible with the intent" of any operative provision of the Code. The rules of Section 708, on the other hand, are to be applied only "[f]or purposes of this subchapter" (Subchapter K relating to partnerships). See Section 708(a). Since Section 318 is not a part of Subchapter K, Section 708(b) is not applicable in determining whether Manchester had been terminated for purposes of the Section 318 attribution rules. Furthermore, as the court of appeals held (Pet. App. 13–16), even if Section 708(b) were applicable, Manchester had not been terminated within the meaning of that provision.

Finally, petitioner's assertion (Pet. 17) of a conflict with *Barran* v. *Commissioner*, 334 F. 2d 58 (C.A. 5); *Hatch's Estate* v. *Commissioner*, 198 F. 2d 26 (C.A. 9); and *Thornley* v. *Commissioner*, 147 F. 2d 416 (C.A. 3), is undercut by its admission (Pet. 20) that the question of what constitutes a termination of a partnership under Section 318 is one of first appellate impression. The cited cases deal only with the question of termination in connection with the partnership provisions of the Code, and, in any event, turn upon factual findings that the partners intended to terminate the partnerships there involved. No similar findings were made here.[6]

[6] *Hatch's Estate* v. *Commissioner*, *supra*, was decided by a three-judge panel of the Ninth Circuit and, of course, is not in conflict with the decision of the Ninth Circuit below.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1954:

SEC. 7701. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

[26 U.S.C. 7701.]

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